

September 1, 2020

The Honorable Dustin Burrows  
Chairman, House Ways & Means Committee  
Texas Capitol E2.722  
Austin, Texas

Re: Comments Regarding Interim Charge #1.

Chair Burrows, Members of the Ways & Means Committee:

Perhaps the most important interim activity undertaken by House Ways & Means is that found in interim charge #1: *Monitor the agencies and programs under the Committee's jurisdiction and oversee the implementation of relevant legislation passed by the 86th Legislature. Conduct active oversight of all associated rulemaking and other governmental actions taken to ensure intended legislative outcome of all legislation, including the following: 2 – HB 1525 and HB 2153 which relate to the collection of sales and use taxes by marketplaces and out-of-state businesses. Monitor the Comptroller of Public Accounts' rules regulating the collection of sales, use, and franchise tax to ensure compliance by marketplace providers and out-of-state businesses and monitor any revenue increases as a result of implementation of these bills*

With this in mind, I have prepared these comments, specifically addressing the passage and implementation of HB 1525 and HB 2153 including the Comptroller's adoption of rules to implement this legislation.

My general impression is that rule 3.334 as adopted goes significantly beyond HB 1525 and HB 2153 of the 86<sup>th</sup> Legislative session and does not clarify existing practice, but rather creates more confusion. These two bills provide the only significant statutory change to chapter 321 of the Tax code over the last decade. However, the adopted rule makes significant changes in several areas that are not supported by statute or legislative intent. Additionally, the rule and perhaps the underlying legislation (HB 1525) does not follow the intent of the legislature with regard to the sourcing of sales made through a Marketplace provider.

Rule 3.334 as adopted disregards clear statutory direction: *Tax Code 321.203(b) If a retailer has only one place of business in this state, all of the retailer's retail sales of taxable items are consummated at that place of business...* The Comptroller has imagined that a retailer with only one place of business does not receive certain orders at its single location, and therefore any orders it magically does not receive "in person" at its single location are sourced to the destination or delivery location.

One misplaced justification for this drastic policy change by the Comptroller is the so called ‘taxation without representation’ argument insinuating that sales tax should always follow the consumer. This was the argument used before this committee and in a Dallas Morning News editorial where the Comptroller wrote: “I’ll bet you never imagined that your taxes were being shipped off to another community...” Taxation without representation is a catchy argument, but one that does not apply to origin vs destination sourcing issues. The phrase also goes immediately to Tax Policy. The Comptroller via this rule and public statements is making new tax policy for the state of Texas without related changes in Texas tax statutes.

If the Legislature had intended for the Comptroller’s office to change Texas from origin to destination-sourcing for all but ‘in person’ transactions via Rule 3.334, then there probably wouldn’t be a need to pen editorials in the Dallas Morning News explaining and defending this tax policy shift. Had the House directed the Comptroller’s office to make a substantive change from origin to destination-sourcing for all transactions involving electronic orders, there would not be a need for Interim Charge #3 that directs this committee to study and consider a change from Origin to Destination sourcing for the state of Texas. Finally, if the Texas Legislature had intended a tax policy change from Origin to Destination sourcing, the Legislature would have probably changed the statute (Tax Code 321.203(a-d)) governing local sourcing of sales and use tax since it’s been tax policy since 1979.

Another argument made by the Comptroller’s office as a pressing need for the changes in Rule 3.334 is that some communities have used a “loophole” in Chapter 380 Local Government Code regarding economic development incentives. The Legislature has a long and successful history of addressing economic development activities and closing loopholes when necessary. This committee and Chairman Murphy did great work on revising and improving Chapter 313 when there was a need to improve or revise that economic development incentive program. The Comptroller’s office did not take care of the issue with an administrative rule reinterpreting Chapter 313. Substantive policy changes then and now are best left to the Legislature.

The opening for changes to Rule 3.334 was provided by the passage of HB 1525 and HB 2153 by the 86<sup>th</sup> Legislature. Both are good tax policy bills authored by Chairman Burrows that received broad support. Those bills addressed marketplace and out of state seller’s requirements to collect and remit Texas’ sales and use tax in light of the U.S. Supreme Court’s ruling in *Wayfair v. South Dakota*.

HB 1525 was passed by the Legislature under the assumption that all marketplace sales would be sourced to the point of delivery to the consumer. A closer read of the bill, and subsequent language adopted by the comptroller in Rule 3.286 and Rule 3.334 requires a marketplace provider to **source only 3<sup>rd</sup> party Marketplace seller transactions on a destination basis**, while leaving sales of the Marketplace provider itself an option for origin-sourcing. The Comptroller has confirmed this reading of the bill and the rule in its response to comments during the adoption of Rule 3.334. It is unclear that the Legislature intended for only 3<sup>rd</sup> party and not all marketplace sales follow the requirements of the bill for destination-sourcing.

It is recommend that the 87<sup>th</sup> Legislature clarify in statute that all sales provisioned via a “marketplace” as defined in statute are required to follow the sourcing rules adopted in HB 1525. There should not be a difference between the way a Marketplace provider like Amazon sources its own sales versus a 3<sup>rd</sup> party seller using the Amazon marketplace platform.

#### **Business Sector Compliance:**

What steps will the Comptroller take to enforce the proposed rule 3.334 and ensure compliance by the business community? Private sector clients of the firm have indicated that the changes in local sales tax compliance outlined in Rule 3.334 will be very expensive to implement.

Existing sales tax compliance software does not contain or allow an input field based upon the method of communication by which an order is received. Furthermore, integration with existing point of sale / customer relationship management software, to add the communication method differentiation and resulting local tax sourcing requirements of 3.334 creates an additional layer of expense, beyond the sales tax compliance software. Estimated compliance costs range from \$100,000 to well over \$2,000,000 for each type of software.

Furthermore, a recent PIA request filed with the Comptroller for all “training materials used/provided the Audit Division and its staff addressing Texas Tax Code Chapter 321 and 34 Tax Administrative Code Rule 3.334” resulted in: “No records are being released in response to this PIA request because this agency has no records that fall within the scope of this request.” This response seems to indicate that a business will not face Rule 3.334 compliance scrutiny under audit.

Given the compliance burden / expense for businesses, and the Comptroller’s practice of not imposing penalties to a permit holders on misallocations, provided they have collected the 2% local maximum local tax, what would compel a business to incur this compliance expense to the detriment of profitability? This question is more relevant given the current economic crisis gripping Texas.

Rule 3.334, not a statutory change by the Legislature, will cause businesses to either spend significant funds to become compliant, or ignore Rule 3.334 in the hopes that they won’t get caught in an audit or face penalties if they do. That in and of itself is not good Tax Policy.

#### **Rule 3.334 favors out of state businesses over Texas merchants.**

The requirements in Rule 3.334 will force Texas merchants to collect and remit use tax on a destination-sourcing basis for virtually all orders not received in person at a place of business. This could potentially require a company that previously only had one place of business in the state, and therefore only one local government code on their sales tax report, to now track shipments to up to 1,500 individual taxing jurisdictions in the state.

However, HB 2153 as passed by the 86<sup>th</sup> Legislature provides that similarly situation businesses without a physical presence in this state may elect to simply collect a single rate (at an amount lower than the 2% maximum combined local rate cap) and remit that to the Comptroller. Out of state businesses will not incur the burden of the complicated destination sourcing calculation required for Texas permit holders by adopted Rule 3.334. The bill analysis for HB 2153 states as much in the Background and Purpose: *Concerns have been raised regarding the ability of sellers who are not physically located in Texas to collect applicable sales and use taxes. It has been suggested that identifying the correct local taxing jurisdictions and calculating the total local use tax due may be challenging for these remote sellers. C.S.H.B. 2153 seeks to alleviate a remote seller's burden in calculating the local use tax in Texas by giving these sellers the option to collect taxes using a single local use tax rate.*

The Legislature and the Comptroller acknowledge the complexity and “burden” of destination sourcing for out of state sellers, but Rule 3.334 imposes ALL of those burdens on Texas merchants. This imposition to Texas merchants was adopted by the Comptroller in Rule 3.334 without any change in the Tax Code 321.203, the statute governing consummation of the sale for existing Texas sales tax permit holders.

**Summary:**

Rule 3.334 as adopted by the Texas Comptroller’s office fundamentally changes tax policy for the State of Texas without corresponding statutory changes. Rule 3.334 puts Texas merchants at a disadvantage to out of state vendors. Rule 3.334 will be expensive for Texas merchants to comply with and is likely to face significant non-compliance as currently adopted. Rule 3.334 does not require all Marketplace transactions to follow the same sourcing rules.

For these reasons, I encourage the Ways & Means Committee to address these issues with the Texas Comptroller’s office and take the necessary steps to correct any outstanding issues in the 87<sup>th</sup> Legislature.

Warm regards,

A handwritten signature in dark ink, appearing to read "John Kroll", with a stylized, cursive script.

John Kroll  
Partner